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THE CASE OF EXTERNAL CAPITAL INFLOWS AND ECONOMIC PERFORMANCE: NEW EVIDENCE FROM NIGERIA

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Abstract
Government is put in place to ensure peace, tranquility, protection and wellbeing of the citizens. By extension, government actions through policies and programmes influence the direction of economic activities such as inflows of external capital; for example foreign direct investment, which are invaluable in the quest for sustainable growth and development in most developing countries such as Nigeria. In this light, this study investigated the impact foreign direct investment has on economic growth in Nigeria for the period 1981 to 2022 using error correction mechanism technique. To this end and based on neoclassical growth model, a model was drawn. The results from the analysis shows that foreign direct investment positively and significantly impact economic growth in the short run and long run. The error correction term was negative and statistically significant indicative amongst others of the existence of co-integrating relationship among variables. Based on the findings of the study, it was held that relevant policies should be put in place to sustain and further attract foreign direct investment inflow to the Nigeria economy.
Keywords: Foreign Direct Investment, Developing Country, Growth, Time Series
JEL: F21, N17, F43, C32

1. Introduction
To govern is to exert official and legal control over a group of person so geographically defined as it relates to protection of lives, property, wellbeing and management of resources therein. Besides being among macroeconomic goals of government, the attainment of economic growth is no doubt a major yardstick of measuring economic performance of a country. While most advanced countries such as France, China, and United States of America have attained impressive growth over time, this is not the case with most developing countries such as Nigeria. This may not be unconnected (though not limited to) the weak production base of most developing countries inclusive of Nigeria compared to advanced countries. For example, Nigeria major exports produce are crude in nature whose price often fluctuates in international markets and as such export produce are at the mercy of the buyers. This no doubt has a detrimental effect on export revenue, domestic savings and by extension growth performance. This has informed the need to seek and exploit other sources of capital such as Foreign Direct Investment (FDI) to complement domestic resources. This is in tune with earlier views held by Edo (2007); and Eregha and Nwokoma (2014) that most developmental economists are in support of increased capital flow to developing countries (in this case, FDI) owing to the fact that FDI is viewed a major driver of economic growth in the literature. Elboiashi (2011) was also in tune with the above position with the assertion that FDI boosts local recipient economy through enhancement of the stock of knowledge and technical know-how.

Several studies may have examined the impact FDI has on growth, the result from the extant literature are mixed (though skewed in favor of positive impact of FDI on economic growth). For example, while Adeleke, Olowe and Fasesin (2014); Olokoyo (2012); Onakoya (2012) found that FDI positively and significantly impact on economic growth, Mazenda (2014) Alege and Ogundipe (2013) found otherwise. Also, besides updating the literature, this

study seeks to provide new evidence in the light of the fluctuating and weak inflow of FDI to Nigeria in recent times using lucid but rigorous econometric techniques.

2. Background Environment

2.1. FDI Flows in Nigeria

Though, UNCTAD (2019) World Investment Report reveals that Nigeria was the third host economy for FDI inflow in Africa behind Egypt and Ethiopia with a total of about US$3.5billion FDI inflow recorded in 2017. However, this amount decreased to about US$1.9billion in 2018 as a result of oil counter-shock, domestic imbalances, and insurgency/terrorism. As expected, this resulted in Nigeria losing his position as a leading recipient of FDI inflow to Ghana within same period.

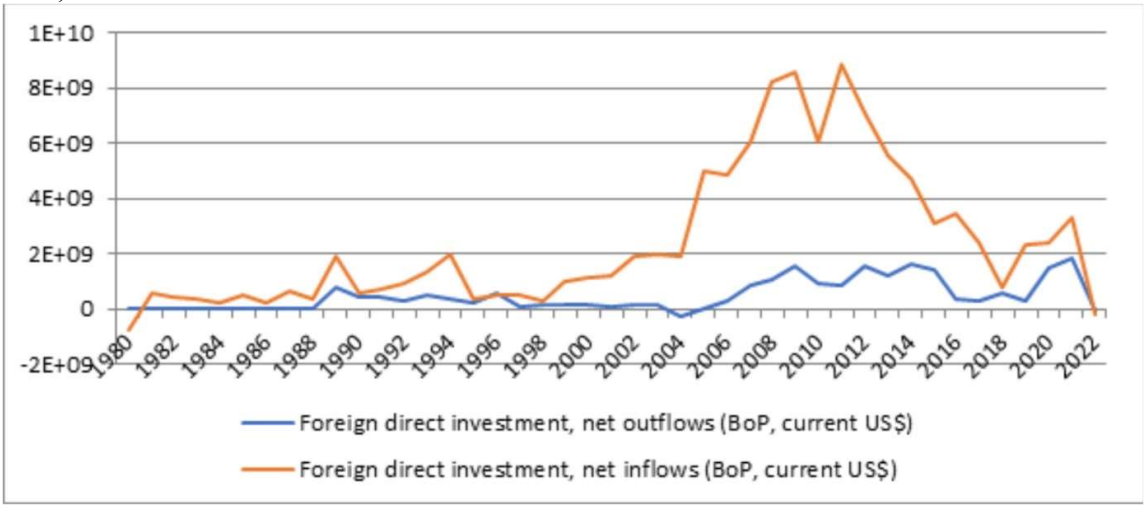
Table 1: FDI inflows to Nigeria and BRICS Countries

Countries / Years	Amount (Millions of US Dollars)					
	2013	2014	2015	2016	2017	2018
Nigeria	5 608	4 694	3 064	4 449	3 503	1 997
Brazil	59 089	63 846	49 514	52 751	67 583	61 223
Russia	53 397	29 152	11 858	37 176	25 954	13 332
India	28 199	34 582	44 064	44 481	39 904	42 286
China	123 911	128 500	135 610	133 710	134 063	139 043
South Africa	8 300	5 771	1 729	2235	2 007	5 334

Source: UNCTAD 2019

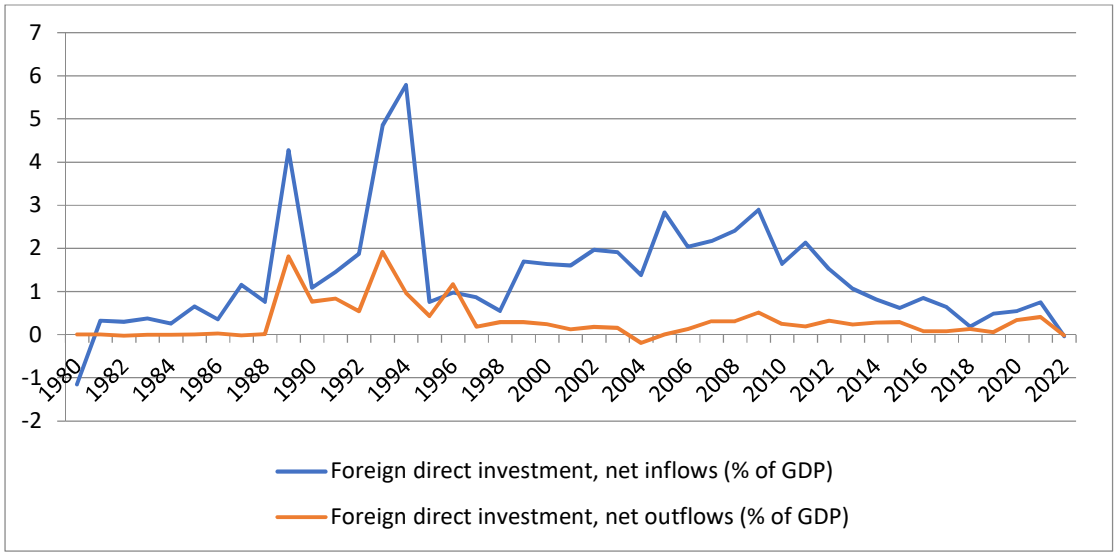
Compared to other emerging market economies, the volume of FDI inflows to Nigeria has been quite low as shown in the Table 1. It can be observed that the amount of FDI inflow to Nigeria for the period 2013 to 2018 was less than the volume of FDI inflow to each of BRICS (Brazil, Russia, India, China and South Africa) countries (see Table 1).

Figure 1: Trend in Foreign Direct Investment (inflow and outflow) in Nigeria- Current US$; 1980 to 2022



Source: Graphed by Author using World Development Indicators, World Bank (2022)

Figure 2: Trend in Foreign Direct Investment (inflow and outflow) in Nigeria – percentage of GDP; 1980 to 2022

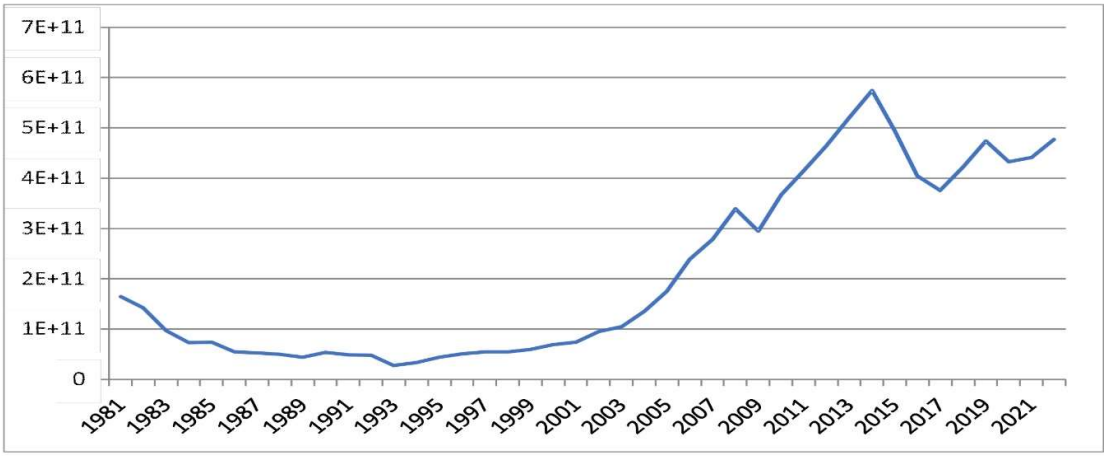


Source: Graphed by Author using World Development Indicators, World Bank (2023)

Figure 1 and figure 2 shows trend in FDI flows in Nigeria for the period 1980 to 2022 as it relates to inflow and outflow in current US$ (as depicted in figure 1) and inflows and outflows in percentage of GDP (as shown in figure 2). From figure 1, it can be observed that both inflows and outflows exhibited a fluctuating pattern indicative of the fact that FDI flows has not been stable in Nigeria; though, the volume of net FDI inflows for the period outweighs the volume of net outflow. Similarly, a cursory look at figure 2 shows that both inflows and outflows as a percentage of GDP exhibited a fluctuating pattern further indicative of the fact that FDI flows has not been stable in Nigeria. Just as obtain in figure 1, FDI flows in percentage of GDP (figure 2) exhibit a higher net volume of inflow compare to outflow fluctuating pattern notwithstanding.

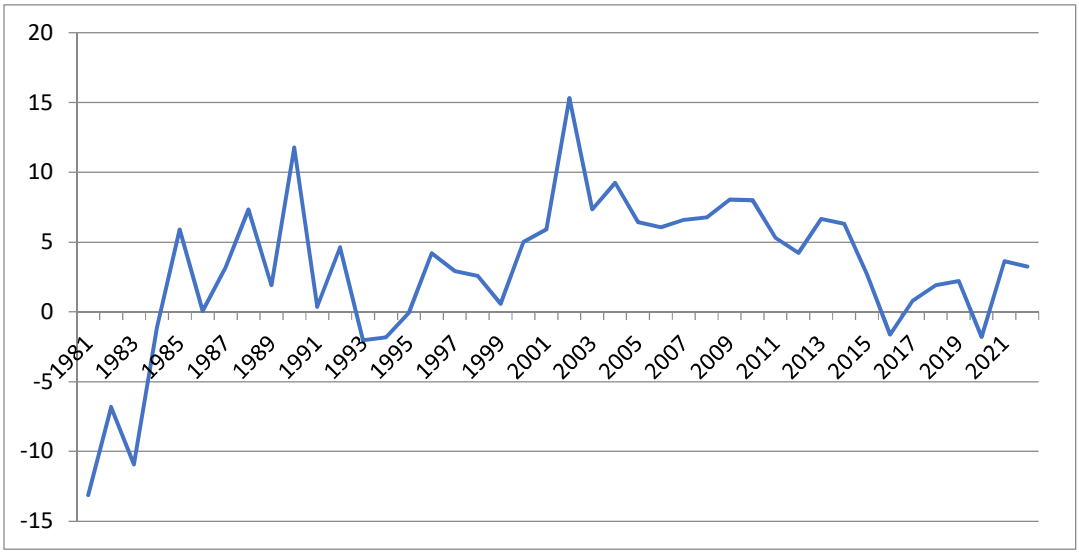
2.2. Volume and Growth Rate of Nigeria Economy 1981 to 2022

Figure 3: Nigeria GDP (current US$) 1981 to 2022



Source: Graphed by Author using World Development Indicators, World Bank (2022)

Figure 4: Nigeria GDP Growth (annual percentage) 1981 to 2022



Source: Graphed by Author using World Development Indicators, World Bank (2022)

From 3 and 4 shows the trend in the volume of Nigeria GDP and GDP annual growth rate respectively. From Figure 3, the graph shows that the size/volume of Nigeria GDP has generally being on a steady increase since the mid-1990. This implies that there has being an increase in the volume of economic activities in the country over the years (1990 to 2022) with the exception of some few years such as 2009, 2015 and 2020 attributed mainly to global financial crisis, drastic fall in the price of crude oil in the international market (main source of foreign exchange of Nigeria) and lock down that characterized outbreak of COVID 19 respectively.

Also, a cursory look at Figure 4 shows that the growth rate of the Nigeria economy has been characterized with fluctuating trend resulting in negative growth rate in some years for the period 1981 to 2022 despite the fact that there has being increase in the volume of economic activities. As shown in figure 4, GDP annual growth rate was in negative for the period 1981 to 1984; 1993 to 1995; 2017 and 2020. This point to the fact that Nigeria economy has not exhibited steady growth necessary for a sustainable economic growth over the years.

3. Review of Literature

3.1. Conceptual Clarification

3.1.1. Foreign Direct Investment

UNCTAD (2013) explained foreign direct investment as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate). This definition implies that the investor exerts significant degree of influence on management of the enterprise or its affiliate resident in another country.

Accordance to IMF (2004), FDI can take the form of green-field investment or merger and acquisition. Greenfield investment (mortar and brick investment) is a form of FDI where a

parent company starts a new venture in a foreign country by constructing new operational facilities. In addition to building new facilities, the parent companies also create new long-term jobs in the foreign country by hiring new employees. Merger and acquisition of an existing local enterprise is a crucial tool for a firm's internationalization strategy. While a merger is a legal consolidation of two companies into one entity, an acquisition occurs when one company takes over completely another firm and establishes itself as the new owner.

3.1.2. Economic Growth

Economic growth is a common measure of economic performance, since it affects national income and living standard of the people. It also helps in achieving other objectives, such as unemployment, government borrowing and real disposable incomes. Economic growth is also frequently used for international comparisons. Economic growths are usually recorded in a country national account such as Gross Domestic Product (GDP), Gross National Product (GNP)/Gross National Income (GNI), Net National Product (NNP) amongst others. While GDP is viewed as a measure of currently produced final goods and services evaluated at market prices (Froyen, 2009), it also records value of output produced in a country by all factors of production owned domestically or owned by non-resident (Obadan, 2012). Obadan (2012) further opined that GNP/GNI is the value of product/income produced/received by residents from factors of production they own anywhere in the world. NNP is GNP less depreciation. Thus, one may therefore view GDP and GNP/GNI as relevant measures of aggregate production activities which can represent economic growth of a country. GDP per capita (GDP divided by total population of a country in a given period) also represent economic growth (Iyoha, Ighodaro and Adamu 2012).

3.2. The Theory

The neoclassical growth theory as espoused by Solow (1956) could be employed to explain FDI-growth relationship. The theory held that growth is generated through accumulation of exogenous factors of production such as capital and labour. In other words, growth is attained through accumulation of factor inputs such as capital (K) and labour (L) with a provision for technical progress (T). Some features of the model includes; constant return to scale, reproducible capital and composite commodity output, marginal productivity to labour and capital, prices and wages flexibility, full employment of capital and diminishing returns. With technical progress, there is the tendency for capital-labour ratio to converge towards equilibrium ratio over time. This means that the long-run per capita growth rate depends entirely on the exogenous rate of technical progress. The model posits further that a rise in the rate of savings results in a short-term rise in per capita (k) and per capita output and that both converge on the path of a steady growth rate at higher level of per capita output. This has been demonstrated in various studies such as Barro and Sala-i-Martins (1995), Mahembe and Odhiambo (2014) to mention a few.

3.3. The Empirics

Ali and Ussain (2017) investigated the impact FDI has on economic growth in Pakistan covering 1991 to 2015 with OLS technique. From the analysis, it was found that FDI positively and significantly impact economic growth. Sarbu and Carp (2015) investigated the effect FDI has on economic growth in Romania for the period 2000 to 2013. OLS technique was employed and it was established that FDI positively and significantly impact growth. It was recommended that relevant policy should be implementation to attract more FDI into the country. Yaseen (2014) investigates the impact FDI has on economic growth in Jordan for the period 1990 to 2012. The result from OLS technique employed point to the fact that FDI, domestic investment

and trade impact positively and significantly affect the growth. Implementations of relevant policies were proffered. Hussain and Haque (2017) examined the effect FDI and trade has on economic growth in Bangladesh spanning the period 1973 to 2014. Cointegration and vector error correction modeling were employed and it was found that FDI and trade impact growth positively and significantly. It was recommended that policies that promote trade and FDI inflow should be implemented.

Meah, Onono and Ocharo (2016) examined the influence of institutional quality on the effect FDI has on economic growth in Kenya for the period 1975 to 2013 with OLS technique. The findings was that FDI inflow exert a positively impact on growth, and that institutional quality enhances the impact of FDI on growth. Hassen and Anis (2012) examined the impact of FDI on economic growth in Tunisia for the period 1975 to 2009 using cointegration and error correction methodology. It was found that FDI positively affects growth over time. It was thereafter suggested among others that the inflow of FDI should be sustained for the overall growth of the economy. Elbolashi (2015) examined the effect FDI has on growth and taking into consideration the importance of host country's characteristics in a sample of 56 developing countries using the system GMM estimation technique. It was found that FDI positively and significantly affects economic growth. This was however depends on underlying factors in host country. Blin and Ouattara (2009) examines the effect FDI has on economic growth in Mauritius for the period 1975 to 2000. ARDL approach to cointegration and error correction mechanism were employed. It was established that FDI impact positively and significantly on growth. The impact of FDI on economic growth in Tunisia for the period 1980 to 2011 was examined by Wahiba (2014) using OLS. Findings from the study point to the existence of a positive and statistically significant impact of FDI on economic growth. Mazenda (2014) employs the methodology of Vector Error Correction Modelling in the examination of the effect FDI has on economic growth in South Africa for the period 1980 to 2010. The study established that FDI negatively and significantly impact growth.

Alege and Ogundipe (2013) investigated the relationship between FDI and economic growth in ECOWAS using the System GMM panel estimation technique covering the period 1970-2011. It was established that the impact of FDI on economic growth was negative though statistically insignificant. Adamu and Oriakhi (2013) employed fixed effect model to examine the impact FDI has on economic growth in the Economic Community of West African States (ECOWAS) for the period 2000 to 2009. It was found that FDI-GDP ratio and exports and human capital positively and significantly impact growth in ECOWAS sub-region.

Olasehinde and Ajayi, (2022) examined the relationship between FDI and growth in Nigeria spanning the period 1981 and 2020. The result from Autoregressive Distributed Lag Bound technique (ARDL) technique employed, it was revealed that FDI positively and significantly impacted on economic growth in the short and long run respectively. Bashir (2022) examined the impact of FDI on growth in Nigeria spanning the period 1986 to 2020 in ARDL model. It was established that FDI positively and significantly impact on economic growth and that growth effect of FDI on growth is enhanced under a stable exchange rate. Adeleke, Olowe and Fasesin (2014) examined the effects FDI, export earnings and exchange rate has on economic growth in Nigeria for the period 1999 to 2013 using OLS estimation technique. It was found that FDI positively and significantly impact on growth. Ugochukwu and Okore (2013) examined the impact FDI has on Nigeria's economy for the period 1981 to 2009. From OLS technique, it was found that FDI positively (though statistical insignificant) impacted on growth in Nigeria.

Olokoyo (2012) investigated FDI-growth nexus in Nigeria spanning 1970 to 2012. From OLS technique employed, it was found that FDI impact growth positively, this was statistically significant. Onakoya (2012) examined the impact of FDI on economic growth in

Nigeria. Simultaneous equation was estimated using 3 stage least squares methodology. The study established that FDI positively and significantly impact growth, though this differs across sectors of the economy. Recommendations such as sector-specific policies and trade openness were proffered. Umoh, Jacob and Chuku (2011) examined the effect FDI has on economic growth in Nigeria using a VECM and a system of simultaneous equations. The study held that there is a positive feedback (bidirectional effect) between FDI and growth. Other studies on the nexus that exist between FDI and growth are Nair-Reichert and Weinhold (2001), Organisation for Economic Cooperation and Development, OECD (2014), Orji, Uche, and Ilori (2014) and a host of others.

4. Theoretical Framework and Methodology

The theoretical foundation on which this study is hinged on is Solow neoclassical growth model. The model expresses output as a function of capital stock, labour and technological change. Its basic form is functionally stated as;

$Y = f(A, K, L)$ (1)

Where:
Y, K, L and A represent output, capital stock, quantity of labor and level of technology respectively.

This model has been modified to obtain the augmented growth model in varied empirical analysis such as Barro (1991); Mankiw, Romer and Weil (1992); Okodua (2016); Izevbigie, Isikhuemen, and Ogbeifun, (2020). Thus, a functional model capturing the effect FDI has on economic growth in Nigeria is specified as:

$GRGPC = f(FDI, DDT, TOPEN, INF)$ (2)

The error correction model is specified as:

$$GRGPC_t = \beta_0 + \beta_1 FDI_t + \beta_2 DDBT_t + \beta_3 TOPN_t + \beta_4 INF_t + \phi ECT_{t-1} + \mu_t \quad (3)$$

Where;
GRGPC = growth rate of real GDP per capita; *FDI* = Net Foreign direct investment as a percentage of GDP; *DDBT* = Domestic debt as a percentage of GDP; *TOP* = Trade openness, measured as total trade as a percentage of GDP; *INF* = Inflation rate; *ECT* = Error correction term; μ = error term; t = indexes of time.

β_1 *to* β_4 are parameters to be estimated and their values could either be positive or negative. The coefficient of the error term (ϕ) is expected to be negative, statistically significant and between zero and one.

4.1. Estimation Technique and Data Sources

Error Correction Mechanism (ECM) technique using Ordinary Least Squares (OLS) procedure by testing for unit root and co-integration is employed. The choice of this technique is premised on its applicability for long run and short run estimates. According to Hendry (1986), the procedure ensures that estimates are not spurious and can be rely upon. For the ECM to

effectively perform this role, the lagged residual coefficient (speed of adjustment, that is, how quickly equilibrium is restored in the event of temporary displacement) must be negatively signed and statistically significant. The data are sourced from Central Bank of Nigeria (2022) and World Bank World Development Indicators (2022).

5. Empirical Analysis

Table 2: Correlation Matrix

	GRGPC	FDI	DDBT	TOP	INF
GRGPC	1				
FDI	0.91611	1			
DDBT	0.87102	-0.8521	1		
TOP	0.2812	-0.7041	0.11455	1	
INF	0.45213	0.92241	0.77021	-0.1276	1

Source: Author's Computation (2023) with EVIEWS using World Development Indicators, World Bank (2022)

From Table 2, it can be observed that all the variables (FDI, DDBT, TOP and INF) are all positively correlated to GRGPC. This means that there is direct link between GRGPC and the explanatory variables.

Table 3: Stationarity Test; Augmented Dickey Fuller (ADF) Unit Root Test

Variables	Level			First Difference		
	ADF Test Stat	Critical Value	Inference	ADF Test Stat	Critical Value	Inference
GRGPC	-2.55	-4.32	NS	-6.32	-4.32	S
FDI	-1.20	-4.35	NS	-6.53	-4.35	S
DDBT	-2.33	-4.35	NS	-6.26	-4.35	S
TOP	-2.60	-4.35	NS	-6.68	-4.35	S
INF	-1.05	-4.35	NS	-6.20	-4.35	S

Source: Author's Computation (2023) with EVIEWS using World Development Indicators, World Bank (2022)

Note: NS represent Non Stationary, S represent Stationary.

From Table 3, unit root results indicate the variables are non stationary at levels but attained stationarity at first difference at 5 per cent significant level.

Table 4: Cointegration Test; Residual Based Cointegration

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-12.1382	0.0000
Test critical values:	1% level	-5.37273	
	5% level	-4.25277	
	10% level	-4.41064	

Source: Author's Computation (2023) with EVIEWS using World Development Indicators, World Bank (2022)

The cointegration test results affirm the existence of a long run convergence among the variables at 5 percent significant level and as such inform a rejection of the null hypothesis of no cointegration of the series.

Table 5: OLS (Long-run) and ECM (Short-run) Estimates

Long run Estimates					**Short-run Estimates**				
Var.	Coeff	Std. Error	t-Stat	Prob.	Var.	Coeff	Std. Error	t-Stat	Prob.
C	8.602	0.1913	44.96	0	C	5.261	0.1537	34.22	0
FDI	3.170	0.5986	5.294	0	FDI	4.199	0.8587	4.889	0.001
DDBT	0.512	0.3645	1.405	0.413	DDBT	1.123	0.5272	2.131	0.015
TOP	-0.430	0.0736	-5.849	0.016	TOP	-0.548	0.1654	-3.316	0.031
INF	-1.26	0.3785	-3.328	0.041	INF	0.417	0.2911	1.432	0.157
R-sq	0.923	Mean dep var		12.36	ECM(-1)	-1.214	0.2696	-4.501	0.003
Adj R-sq	0.911	S.D. dep var		0.761	R-sq	0.8986	Mean dep var		9.472
F-stat	114.2				Adj R-sq	0.8921	S.D. dep var		0.225
Prob(F-stat)	0				F-stat	111.25			
					Prob(F-stat)	0			

Source: Author's Computation (2023) with EVIEWS using World Development Indicators, World Bank (2022).

From Table 5, the long run estimate shows that FDI is positively related to economic growth. FDI impact on economic growth is statistically significant at 1 percent showing that one percent increase in FDI inflow leads to over 3 percent increase in economic growth. Similarly, domestic debt exhibited a positive impact on economic growth, though not statistically significant. Trade openness exhibited negative impact on economic growth at 5 percent significant level. From the result, a one percent increase in trade leads to about 0.43 percent decline in economic growth. Also, inflation rate was found to exhibit negative impact on economic growth and was statistically significant at 5 percent level. A 1 percent rise in inflation rate resulted in about 1.2 percent reduction in economic growth. The R-square and adjusted R-square values were about 0.92 percent and 0.91 percent respectively indicative that about 92 percent and 91 percent variations in economic growth were accounted for by the explanatory variables. This F-statistics value of over 114 attested further to the high explanatory powers of the variables.
Similar results were revealed in the short run as it relates to FDI in Table 5. From the table, FDI exhibited a positive relationship with economic growth and this was also statistically significant at 1 percent level. A one percent rise in FDI resulted in over 4 percent increase in growth. Meanwhile, Domestic debt was found to exhibit positive impact on economic growth and this was statistically significant at 5 percent level. A one percent rise in domestic debt leads to about 1.12 percent rise in economic growth. Akin to the result in the long run, trade openness exhibited negative impact on growth at 5 percent statistical significant level. A one percent rise in trade result in about 0.54 percent decline in growth. In contrast to the long run, inflation rate exhibited positive impact on economic growth, though not statistically significant. The R-square and adjusted R-square values of approximately 0.90 percent and 0.89 percent respectively shows that about 90 percent variations in growth were accounted for by the explanatory variables. The F-statistics value of over 111also attested to the explanatory powers of the variables.

Lastly, from Table 5, the ECM was negative sand statistically significant. Its coefficient (in absolute terms) of 12.1 shows that in the event of displacement from the path of equilibrium, adjustment to equilibrium rate is about 12.1 percent.

5.1. Implications of Findings

The positive and significant impact of FDI on growth in Nigeria suggests that the inflow of FDI to the Nigeria enhance growth. This is in line with findings from previous studies such as Hassen and Anis (2012), Sarbu and Carp (2015), Ali and Ussain (2017). The negative and significant impact of trade openness on growth in Nigeria implies that contrary to theoretical prediction, openness of Nigeria's economy to international trade adversely affected its growth. This could be attributed to the fact that Nigeria is a marginal player in the international trade because of the exports of mainly primary produce whose prices often fluctuates in international markets. Lastly, there was a disconnect in the long and short run as it relates to the impact domestic debt has on growth as well as the impact of inflation rate has on growth in Nigeria.

6. Conclusion and Recommendations

Owing to the growth impact of FDI inflow in an economy, this study examined the impact FDI has on economic growth in Nigeria for the period 1981 to 2022. The result aligned with most previous similar studies which affirmed that FDI has a positive relationship and a statistically significant impact with economic growth in both the short run and long run. The impact of domestic debt as it relates to growth was also positive, but significant only in the short run. Trade openness exhibited a negative and significant impact on growth in the long and short run respectively. Inflation rate was also found to exhibit negative and significant impact on growth in the long run while a positive though insignificant impact was established in the short run. The coefficient of ECM was negative and statistically significant in tune with theory.

In this regards, policy options put forward are stated in the following paragraphs.

Individuals in position of authority especially in developing countries such as Nigeria should be mindful of the fact that their actions or inactions could either make or mar the inflow of external resources (in this case, foreign direct investment inflows) to the economy.

Policy makers in Nigeria should therefore put in place/improve upon policies to continually attract and sustain FDI inflows to Nigeria.

As a follow up from above, key policies in this regards could be directed at provision of infrastructure, security of life and investment and existence of strong institutions that guarantee rule of law and periodic credible electoral process.

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